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1722 EYE STREET, N.W.
WASHINGTON, D.C. 20006
TELEPHONE 202 736 8000
FACSIMILE 202 736 8711
www.sidley.com
FOUNDED 1866

BEIJING
HONG KONG
LONDON
SHANGHAI
SINGAPORE
TOKYO

WRITER'S DIRECT NUMBER
(202) 736-8224

WRITER'S E-MAIL ADDRESS
cbeckner@sidley.com

August 19, 2003

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, D.C. 20554

Re: 1993 and 1994 Annual Access Filings, Verizon's Direct Case, CC Docket Nos. 93-193,
94-65, 94-157.

Dear Ms. Dortch:

I submit this letter on behalf of AT&T Corp. ("AT&T") in response to new arguments raised by Verizon for the first time in its Rebuttal to AT&T's Opposition to Verizon's Direct Case in the ongoing tariff investigations in the above-captioned proceedings with respect to certain "exogenous cost" increases in Verizon's 1993 and 1994 interstate access tariffs. In December 1990, FASB adopted Statement of Financial Accounting Standards Number 106 ("SFAS-106"), which established new financial accounting and reporting requirements for other post-employment benefits ("OPEBs").¹ SFAS-106 was purely an accounting change that had no cash flow impact on Verizon. Although Verizon was *not* required to implement SFAS-106 in either its financial accounting books or its regulatory books until December 15, 1992 and January 1, 1993, respectively,² it voluntarily implemented SFAS-106 in 1991. In its 1993 and 1994 interstate access tariffs Verizon sought an upward exogenous cost adjustment to its price cap indices ("PCIs") to recover costs purportedly incurred from its early adoption of SFAS-106. The Commission suspended those tariffs and set them for investigation. In February 2003, the

¹ OPEBs are post-employment benefits other than pensions, such as retiree health, life, and dental insurance.

² SFAS-106 was a GAAP change, *i.e.*, it affected carriers' financial books. Although the Commission requires the LECs to keep regulatory accounting books separate from financial accounting books, the Commission's longstanding policy generally is to conform regulatory accounting requirements for LECs to GAAP, unless the GAAP principle conflicts with the Commission's regulatory objectives. *See* Report and Order, 102 F.C.C.2d 964 (1985); 47 C.F.R. § 32.16.

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Commission, recognizing that this issue was still pending and unresolved, issued an order requiring parties to update the record on these issues.³

As AT&T explained in its Opposition to Verizon's Direct Case, two separate Commission rules bar Verizon from obtaining exogenous cost treatment for any pre-1993 SFAS-106 costs. First, the Commission's rules state that "no GAAP change can be given exogenous treatment until FASB has actually approved the change and it has become effective."⁴ Here, FASB approved the OPEB accounting change in December, 1990, and the "effective date" of that order, as clearly stated on the front of the FASB approval, was December 15, 1992. Thus, the plain language of the Commission's rules precludes Verizon from seeking exogenous treatment of any costs it incurred for OPEB-related accounting change prior December 15, 1992.

Second, the Commission's rules permit LECs to obtain exogenous treatment only for costs that are "beyond th[eir] control."⁵ It is undisputed that implementation of SFAS-106 was not mandatory for LECs' regulatory books until January 1, 1993, and implementation *prior* to that date was entirely *within* Verizon's control. Verizon is thus barred from obtaining exogenous cost adjustments associated with implementation of SFAS-106 prior to January 1, 1993, when adoption became mandatory.

Because Verizon was clearly prohibited from implementing exogenous cost increases to its PCIs in 1993 and 1994 to reflect pre-1993 SFAS-106 costs, ratepayers are entitled to refunds for the amounts that Verizon's unlawful conduct inflated interstate access rates. AT&T demonstrated (Opposition, Exhibit 1) that Verizon's unlawful exogenous cost adjustment for pre-1993 implementation SFAS-106 amounted to \$37.5 million for 1993 and \$3 million for 1994.

In its Rebuttal, Verizon argues that even if its rate increases for 1991/92 OPEB costs violate Commission rules that were in effect when the tariffs were filed – as they quite clearly do – it should not be required to pay refunds. More specifically, Verizon claims, without support, that it had sufficient "headroom" in its 1993 and 1994 price caps to avoid any refund obligations. This new argument is specious.

Verizon Is Liable For Refunds. Verizon asserts that "even if the Commission disallowed all of Verizon's 1991-1992 OPEB costs," "no refunds would be due" because, according to Verizon, although it implemented these exogenous cost increases, which raised Verizon's price caps by \$39 million, Verizon's actual access rates were more than \$39 million below its price caps.⁶ Therefore, Verizon concludes, even if the Commission determines that the pre-1993

³ For a comprehensive procedural history, see AT&T Opposition to Verizon's Direct Case at 4-10.

⁴ See, e.g., Second Report and Order, *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd. 6786, ¶ 168 (1990) ("1990 Price Cap Order").

⁵ *Id.* ¶ 166.

⁶ Rebuttal at 10. Verizon also claims that that \$0.7 million of the \$37.5 million in pre-1993 SFAS-106 exogenous cost increases identified by AT&T was associated with billing and collection costs (not SFAS-106 costs), and that this amount was not included in Verizon's price cap rates or in its price cap index calculation. AT&T has been
(continued . . .)

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SFAS-106 related exogenous cost adjustments should be removed from Verizon's 1993 and 1994 price caps, the resulting price caps still would be above the rates Verizon charged after making the challenged exogenous cost adjustments.

Verizon provides no support for this bare assertion, and Verizon obviously would have raised it earlier – and more prominently – if it could be supported. As an initial matter, “headroom,” as Verizon well knows is computed on a basket-by-basket basis. Thus, to properly compute headroom it is necessary to reduce Verizon's price cap indices *for each basket* (i.e., common line, traffic sensitive, special access, and interexchange) by the amount of unlawful costs allocated by Verizon to each basket. This is important because Verizon had more headroom in some baskets and less headroom in other baskets. For example, in 1993, Verizon's special access basket contained only about \$0.1 million in headroom. And Verizon inflated its special access basket in 1993 by more than \$5 million in unlawful 1991/92 OPEB costs. Accordingly, Verizon is subject to a \$5 million refund for its 1993 special access basket alone.

AT&T attaches to this letter an updated analysis showing the proper computation of Verizon's headroom in 1993 and 1994 on a basket-by-basket basis. As this analysis shows, substantial refunds would be due even if *all* of this headroom were available for use by Verizon now. These computations, however, do not reflect headroom that Verizon has already used to avoid other refund obligations. For example, in 1997, Verizon already used at least a portion of its headroom in 1993 and 1994 to avoid refunds for other unlawful conduct.⁷ It is obviously Verizon's burden to demonstrate (and deduct from otherwise available headroom) the full amounts which it has historically applied to its 1993 and 1994 headroom.

Verizon's headroom assertions also fail to remove from Verizon's 1993 and 1994 interstate access headroom the unlawful components at issue in other ongoing investigations of Verizon's 1993 and 1994 price caps. For example, Verizon's 1993/94 tariffs were also substantially and unlawfully inflated with improper “add-back” adjustments.⁸ If Verizon uses any 1993/94 headroom here, it cannot use it to avoid add-back-related refunds. Verizon plainly bears the burden of demonstrating that its headroom calculations reflect *all* downward

(... continued)

unable to confirm whether Verizon is correct (Verizon's tariffs are unclear in this regard). Verizon further states that the \$3.0 million figure identified by AT&T is an annual figure, and that Verizon actually recovered only \$2.2 million in exogenous SFAS-106 related costs for the 8.5 months of the pre-1993 tariff period. AT&T has confirmed that the \$3.0 million figure was, as Verizon notes, an annualized figure and that the portion of the \$3.0 million that is attributable to Verizon's pre-1993 adoption of SFAS-106 should be \$2.2 million. Implementing both of these changes, even Verizon concedes that Verizon's 1993 and 1994 price caps were inflated by at least \$39 million due to exogenous cost treatment of purported costs associated with pre-1993 implementation of SFAS-106.

⁷ See, e.g., Submission of Revised 1997 Tariff Review Plan (TRP) letter filing for Compliance with Commission's Memorandum Opinion and Order, CC Docket Nos. 93-193 *et seq.*, (May 8, 1997) (avoiding refunds associated with its miscalculation of the “g” factor by offsetting those amounts with purported headroom in its 1993 and 1994 tariffs).

⁸ Comments of AT&T Corp., CC Docket Nos. 93-193, 94-65 (May 5, 2003).

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adjustments to its 1993 and 1994 price caps that have already been (or will soon be) required by the Commission. And Verizon plainly has failed to satisfy that burden – indeed, it did not even attempt to reflect past adjustments the headroom in its 1993 and 1994 price caps.

Verizon's New "Effective Date" Arguments Are Meritless. As noted, the Commission's rules state that "no GAAP change can be given exogenous treatment until FASB has actually approved the change and it has become effective."⁹ Here, FASB approved the OPEB accounting change in December, 1990, and the "effective date" of that order, as stated on the front of the FASB approval, was December 15, 1992. According to Verizon, however, the relevant "effective date" should not be the date on which the FASB rule change itself become effective, but instead the date on which the *Verizon* made the rule effective for its own internal accounting purposes. But that interpretation of the rule is flatly prohibited by clear Commission precedent, and would render the Commission's rule meaningless.

The "effective date" rule, as adopted in the Commission's *1990 Price Cap Order* (¶ 168), was a formal adoption of the standards set forth in an earlier 1990 Order that rejected AT&T's attempt to obtain exogenous cost treatment of the same type of accounting changes sought by Verizon.¹⁰ In that 1990 proceeding, AT&T argued that FASB would soon adopt the SFAS-106 changes, and that FASB would make those changes mandatory by 1992. AT&T further argued, as Verizon does here, that it already had internally made those changes effective. The Commission rejected AT&T's claims, explaining that exogenous cost treatment of the accounting changes would be appropriate only after "mandated by FASB or th[e] Commission."¹¹ The Commission thus made clear that the relevant "effective" date (or mandatory adoption date) is that set by FASB or the Commission, not by the carrier seeking the exogenous cost change.

In addition to being at odds with Commission precedent, Verizon's proposed interpretation of the Commission's rules must be rejected because it would render those rules meaningless. Under Verizon's interpretation of the rules, all carriers could obtain exogenous cost treatment for any accounting change adopted by the FASB or the Commission, regardless of whether the rule change had formally become effective, *i.e.*, mandatory for all carriers. Indeed, the requirement that exogenous costs could be sought only after the "effective date" of the rule

⁹ See, e.g., *1990 Price Cap Order* ¶ 168.

¹⁰ Memorandum Opinion And Order, *American Telephone and Telegraph Company Revisions to Tariff* FCC Nos. 1, 2, and 13, Transmittal No. 2304, 5 FCC Rcd. 3680 (1990) ("AT&T OPEB Order").

¹¹ *Id.* ¶ 3.

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change that caused those costs would be meaningless, as each carrier could unilaterally set the "effective date." Verizon's inclusion of 1991/92 OPEB costs was plainly unlawful, and substantial refunds should be required.

Respectfully submitted,

/s/ C. Frederick Beckner III

C. Frederick Beckner III

Attachment

**Impact of Bell Atlantic Including 1991 and 1992 OPEB Exogenous Costs
In its 1993 Annual Filing ***

	(A)	(B)	(C)	(D)	(E)	(F) = (B+C+D)
	<u>Line Description</u>	<u>Common Line</u>	<u>Traffic Sensitive</u>	<u>Specials</u>	<u>Interexchange</u>	<u>Total</u>
Line 1	Below Cap \$ 7/1/93-6/30/94	\$18,242,814	\$25,731,223	\$152,195	\$1,798,425	\$44,126,232
Line 2	1991 and 1992 OPEB Exog Cost	\$16,509,680	\$13,883,140	\$5,628,300	\$1,500,880	\$36,021,120
Line 3	Exogenous Cost Refund	\$0	\$0	\$5,476,105	\$0	\$5,476,105

**Impact of Bell Atlantic Including 1991 and 1992 OPEB Exogenous Costs
In its September 1, 1994 Tariff Filing ***

	(A)	(B)	(C)	(D)	(E)	(F) = (B+C+D)
	<u>Line Description</u>	<u>Common Line</u>	<u>Traffic Sensitive</u>	<u>Trunking</u>	<u>Interexchange</u>	<u>Total</u>
Line 1	Below Cap \$ 7/1/94-6/30/95	\$0	\$22,757	\$2,892	\$1,210,031	\$25,649
Line 2	1991 and 1992 OPEB Exog Cost	\$1,012,380	\$366,180	\$667,740	\$107,700	\$2,046,300
Line 3	Exogenous Cost Refund	\$1,012,380	\$343,423	\$664,848	\$0	\$2,020,651

* Bell Atlantic Transmittal No. 690.